

New Jersey State Investment Council

October 13, 2011 Regular Meeting Minutes

Minutes of the Regular Meeting

Held October 13, 2011 at 10:00 AM at in the NJ State Museum Auditorium, 205 West State Street, Trenton NJ.

Council Members in Attendance:

Robert Grady, Chair
Marty Barrett
Brendan T. Byrne, Jr.
James Hanson, II
Guy Haselmann
James Joyner
James Marketti
Peter Maurer (Telephonic until 10:39)
Timothy McGuckin
Jeffrey Oram

The Regular Meeting was called to order by Chair Grady at 10:15 AM.

Roll Call and Meeting Notice

Ms. Christine Eckel performed roll call and reported that notice of the Regular Meeting scheduled for October 13, 2011 was posted on the Division's website and faxed to the Times of Trenton, the Star-Ledger, the Bergen Record, the Courier Post and the Secretary of State on October 4, 2011. A copy of the notice was posted at the Division and is on file.

Approval of Minutes for Regular Meeting held July 21, 2011

Chair Grady asked the Council Members if they had any comments on the minutes for the July meeting. There was a short discussion about the description of Mr. Kellogg's departure and Mr. Grady suggested that it correctly states that Mr. Kellogg resigned, as he did so in advance of the upcoming expiration of his term. A motion was made by Chair Grady to approve the minutes for the July 21, 2011 meeting, with Council Member Haselmann seconding the motion. All Council Members voted in favor.

Election of Chair and Vice Chair

Council Member Oram, chair of the Nominating Committee, reported that the Nominating Committee, consisting of Council Members Oram, Haselmann and McGuckin, met on August 5, 2011. Mr. Oram then put forth by motion the Nominating Committee's nomination of Chair Grady to continue as Chair, with Council Member Haselmann seconding the motion. There were no other nominations. Council Member Barrett moved to close the nominations and Council Member Byrne seconded the motion. All Council members voted in favor of closing the nominations. Chair Grady and Council Member Marketti abstained from the vote for Chair, with the remainder of the Council members voting in favor of Chair Grady. Council Member Oram then put forth by motion the Nominating Committee's nomination of Council Member Byrne as Vice Chair with Council Member Haselmann seconding the motion. Mr. Marketti nominated Mr. McGuckin for Vice Chair, stating that traditionally one of the two positions was held by an employee representative. Chair Grady stated that he intended to appoint Council Member McGuckin as Chair of the Audit Committee, stating that was a better position from which to represent the plan members. He also stated that it was his intention to nominate Council Member McGuckin to continue as a member of the Investment Policy Committee. Council Member Oram stated that since the Vice Chair runs the meeting in the Chair's absence, he felt that Council Member Byrne's experience made him an excellent choice for Vice Chair. Council Member McGuckin thanked Mr. Marketti for the vote of confidence. He stated that while he was not declining the nomination, he was comfortable with and stood by the recommendation of the Nominating Committee. With respect to the vote for Council Member Byrne for Vice Chair, Council Members Byrne and Marketti abstained, with all other members voting in favor.

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Appointment of members to Executive Committee, Audit Committee and Investment Policy Committee

Chair Grady appointed Council Member McGuckin as Chair of the Audit Committee and stated that Chair Grady would also be a member. Council Member Marketti declined Chair Grady's invitation to participate as a member, stating that his term had expired and he was in a holdover capacity until his replacement was named. Chair Grady stated his intention to appoint an additional plan member to the Audit Committee once the current Council vacancies are filled.

Chair Grady stated that the Investment Policy Committee had been reconstituted over the course of the last year, and it was his intention to continue the current membership of Council Members Byrne, Haselmann, McGuckin and Oram, in addition to himself.

Chair Grady stated that the Bylaws require the nomination of an Executive Committee, although during his tenure the Committee had not met. He stated that since the Investment Policy Committee meets on a regular basis, he believed it efficient to appoint, and therefore did appoint, each of the Investment Policy Committee members named above to also serve on the Executive Committee.

Director's Report for August 2011

Director Walsh reported that the Fiscal Year 2011 audited performance numbers had become available. The Total Fund, excluding Police and Fire mortgages returned 18.03% outperforming the Fund's custom benchmark by 100 bps, in large part due to the overweighting of Domestic Equity and the underweighting of Fixed Income for the fiscal year. Total assets of the Fund were approximately \$73.7 billion, up \$6.9 billion from the start of the fiscal year net of pension payments. US Equity, Fixed Income, Commodity, Private Equity, Real Estate and Hedge Fund portfolios all outperformed their benchmarks, while the internally managed international portfolio lagged its benchmark. Banks loans and high yield fixed income were particular strong performers for fiscal 2011. Both Mr. Grady and Mr. Haselmann congratulated the Director and the Division on their performance for fiscal 2011.

Director Walsh explained that for the last 5 years the Fund's returns on a risk adjusted basis was in the top 20% of Public Funds with over \$20 billion in assets. The Fund's nominal return over the last 5 years ranked in the top 37 percentile. The Director credited his predecessor, William Clark, and some tactical decisions in 2006/2008, for being integral to the Fund's return over the last five years.

Director Walsh next provided an update on the performance of the Fund for the first quarter of fiscal 2012. During the quarter, the Fund was down 6.89%, although the Benchmark was down 10.49%.

The Director spoke about the very challenging global markets with the S&P 1500 down approximately 7.5% and the International equity benchmark down approximately 11% for the quarter. He mentioned that it was the Dow Jones worst quarter since 2009 and the German equity index was down over 30% for the quarter. Conversely, the flight from equities resulted in US Treasuries having their best quarterly return since 2008. The Director reported that there were some bright spots since the end of the quarter, as equity markets were higher since September 30th through the Council meeting date largely attributable to renewed optimism regarding the European credit issues.

Next, Director Walsh presented a handout titled, "Why we invest in Alternatives". He thanked Mr. Barrett for encouraging him to present this to the entire SIC. Director Walsh explained the history of the alternative investment program, which originated after the losses endured by the Fund in its public equity positions in the 2000-2002 eras. The point of the alternative investment program was and is to provide diversification from long only equity risk and exposure to less correlated asset classes.

The alternative investment presentation focused on how in many cases, alternative investment firms attract better talent because alternative managers generally have better incentives and greater alignment with shareholders than

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publicly traded company management. Also, in many cases the fees of alternative management funds are less than their comparable traded publically funds.

The Council next was briefed by Division staff and consultants on a series of proposed private equity, hedge fund, and real estate investments, as follows:

Private Equity

Sterling Capital Partners

Christine Pastore along with Harshal Shah of Strategic Investment Solutions (SIS) proposed a \$100 Million investment in Sterling Capital Partners IV, L.P. Fund ("SCP IV or the "Fund") a Top Quartile, Mid-market Buyout Firm based out of Chicago that will target 5-6 platform investments per year. Sterling will principally execute a buy and build strategy, investing \$24-\$200 million in equity over time per investment. This Fund is structured to produce favorable risk returns on investments. Fees were vetted and negotiated at 2%, 1.5% for commitments over \$1 Billion.

AnaCap

Christine Pastore along with Harshah Shal of SIS proposed an investment of £70 million in AnaCap Credit Opportunities II, L.P. ("ACOF II" or the "Fund"). AnaCap Financial Partners, with £1billion of assets under management, is a specialist private equity investment advisor established in 2005. ACOF II is the second fund formed under the AnaCap financial platform investing in portfolios of distressed debt assets in Europe.

ACOF II is targeting £250 million, with a hard cap of £350 million. Fund II targets investments ranging in size between £5 million and £50 million in 12-20 transactions, with expected average holding periods of four to six years.

TPG

Christine Pastore and Jason MacDonald along with Harshal Shah of SIS proposed an investment of \$100 million in TPG Opportunities Partners II, L.P., (TOP) and an aggregate of \$200 million into two separate accounts (New Jersey/TPG NPLs--Commercial & New Jersey/TPG NPL's--Residential). TOP was formed in 2009 to capitalize on liquid and illiquid credit dislocations and other special situations on a dynamic basis across various economic cycles.

The proposed separate accounts will take advantage of the opportunity within the Commercial and Residential non-performing loan space. These accounts will participate alongside TOP II. It should also be noted that these vehicles will have a three year investment period with the option for NJ to extend. The Division has also negotiated what it believes are favorable terms with a management fee of 0.5% on invested capital and a 15% carry.

Tenaya VI

Christine Pastore along with Harshal Shah of SIS proposed an investment of \$40 million in Tenaya Capital VI Fund. Tenaya Capital, LLC is a venture capital investment partnership focused on investments in mid- to late-stage venture backed technology companies. Tenaya is currently raising Tenaya Capital VI, L.P. ("Fund VI") targeting \$300 million with a hard cap of \$400 million. Fund VI targets equity investments ranging from \$5 million to \$10 million with follow-on financings bringing the total to \$10 million to \$15 million per company in roughly 30 companies.

Real Estate Investment

Wheelock

Sally Haskin of Callan Associates presented the proposed \$150 million investment in Wheelock Street Real Estate Fund (WSREF) to the Council. WSREF is a U.S. based opportunistic real estate fund sponsored by Wheelock Street Capital that is currently targeting approximately \$500 million of capital commitments from a limited number of investors. Ms.

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Haskin reported to the council that WSREF will invest in a broad range of real estate and real estate-related assets throughout the United States, the first commingled fund offered by the Firm.

Hedge Fund Investments

Value Act Capital Partners II

Maneck Kotwal along with Jake Walthour of Cliffwater proposed an investment of up to \$150 million in ValueAct Capital Partners II, LP Fund managed by ValueAct Capital. ValueAct Capital ("VAC" or the "firm") was founded in 2000 by Jeffrey Ubben, George Hamel and Peter Kamin (retiring at end of 2011). The firm currently manages \$6.0 billion in its flagship activist fund, ValueAct Capital Master Fund, L.P. ("ValueAct" or the "fund"). The firm is majority owned by eleven partners. At 8% of NAV, ValueAct's employees are, collectively, one of the fund's largest investors. ValueAct runs a concentrated activist strategy focused on 10 to 18 core investments and 2 to 5 smaller positions requiring further intensive due diligence. Investments are predominately in U.S. mid-cap equities. The fund acquires significant (typically 5% to 15%) ownership stakes in companies with high cash flow yield and cash flow growth which are trading at considerable discounts to comparable private market valuations. The proposed investment has 3-year lock up (2-year hard lock, 1-year soft lock), a 1.25% management fee (reduced from 1.50% due to our planned investment of \$150 million) and a 20% performance fee with 8% preferred return.

Brevan Howard Master Fund

Maneck Kotwal along with Jake Walthour of Cliffwater proposed an investment up to \$200 million in Brevan Howard LP. Brevan Howard (the "Firm") which was founded in 2002 by five former members of the Credit Suisse First Boston ("CSFB") Developed Markets Rates trading team. The Firm's flagship fund, the Brevan Howard Master Fund Limited ("BHMF" or the "Fund"), is a global macro strategy with exposure predominantly to global fixed income and foreign exchange markets. As at 31 August 2011, the Firm is estimated to manage over \$34 billion in assets, including \$26.1 billion in BHMF. The Firm expects to add new trading strategies as investment opportunities present themselves. BHMF has produced excellent risk-adjusted returns. From inception through August 2011, the strategy generated an annualized return of 13.63% with volatility of 7.365%, resulting in a Sharpe ratio of 1.42. The fund's risk adjusted performance place it in the top quartile among all hedge funds and within the Global Macro universe. Brevan Howard charges a 2% management fee and 25% performance fee. All investors pay an additional operational service charge of 0.50% per annum. The fees, while high in comparison to the general hedge fund universe, are in-line with most other global macro funds. The top funds in the space charge a 2% to 4% management fee and a 20% to 30% performance fee. Liquidity for BHMF provides for a one year "soft" lock up and thereafter 5% redemption fee on redemptions in excess of 25% of the investor's holdings in any consecutive three month period with monthly liquidity upon 90 days redemption notice. Redemptions are subject to investor level and fund level gating mechanisms.

Elliott Associates

Maneck Kotwal along with Jake Walthour of Cliffwater proposed an investment of \$200 million in Elliott Associates, LP, which will be allocated to the credit hedge fund asset allocation category. Elliott Management Corporation ("Elliott" or the "firm") manages more than \$17 billion in its hedge fund strategy. Elliott has consistently maintained a "contrarian" view of the risks facing investors in financial assets, and this has historically led Elliott to find areas of investment opportunity that are relatively less crowded. Since inception in February 1977 through November 2010, Elliott Associates, L.P. has generated an annualized net return of 14.40% and a standard deviation of 4.13%, resulting in a Sharpe ratio of 1.78. Since January 1990 through July 2011, Elliott has generated a return of 13.10%. In comparison, the HFRI Fund Weighted Composite Index and the HFRI Event Driven (Total) Index have returns of 11.80% and 12.23% respectively. The returns place them in the top quartile among peers on a risk adjusted basis. Year-to-date as of July, Elliott has produced a return of 4.79%, while the aforementioned indices have produced returns of 1.23% and 2.78% respectively. Elliott continued its strong performance in August with a return of 0.8%, bringing the YTD return to 5.7%. It

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should also be noted that in 2008, Elliott was down 3.08%. In comparison, the S&P 500 was down 37% during the same year.

Winton Futures Fund (add-on)

Maneck Kotwal along with Jake Walthour of Cliffwater proposed an add-on investment of up to \$100 million in Winton Futures Fund. Winton Capital Management (“Winton”) has \$23.9 billion under management, of which the Winton Futures Fund (“WFF”) accounts for \$8.8 billion. WFF is a systematic commodities trading advisor trading 120 futures markets across equities, fixed income, currencies and commodities. There are few key differentiators for Winton relative to peers. Winton’s volatility target of 7-10% is significantly lower than many peers which typically target 15-19%. According to WFF, this allows WFF to take less risk and limits large draw downs. WFF has a long performance history extending almost 14 years. The fund’s annualized return of 11.43% over the last 5 years significantly exceeds the 4.79% return of the HFRI Fund Weighted Composite Index and the 5.95% annualized return of the HFRI Macro (Total) Index. This performance places WFF in the top quartile of all hedge funds and of global macro hedge funds. Winton charges a 1% management fee, which is below the typical 2% fee charged by most hedge funds, and a 20% performance fee. The firm allows for monthly liquidity with no lock up and no gate.

Centerbridge (add-on)

Maneck Kotwal along with Jake Walthour of Cliffwater proposed an additional investment of \$60 million in Centerbridge Credit Partners Fund, L.P. (the “Fund”). NJDOI previously invested \$140 million in the Fund in two separate commitments (November 2007 - \$100 million & January 2011 - \$40 million). The investment has a market value as of 6/30/11 of \$201.6 million (1.44x). It should also be noted that in addition to its hedge fund commitments, NJDOI has made commitments to the firm’s private equity funds, Centerbridge Capital Partners I (\$80 million) and Centerbridge Capital Partners II (\$100 million). Centerbridge Capital Partners I is one of the private equity portfolio’s top performers. Centerbridge manages \$17.2 billion in investments within both hedge funds and private equity funds, as of August 31, 2011. Since inception in November of 2007, Centerbridge Credit Partners has generated a return of 12.67%. In comparison, the HFRI Fund Weighted Composite Index and the HFRI Event Driven (Total) Index have returns of 1.72% and 2.39% respectively. The returns place them in the top quartile among peers. Year-to-date as of July, Centerbridge Credit has produced a return of 5.6%, while the aforementioned indices have produced returns of 1.23% and 2.78% respectively.

Asian Century Quest Fund (add-on)

Maneck Kotwal along with Jake Walthour of Cliffwater proposed an addition of \$75 million to our investment in Asian Century Quest Fund (QP), LP (the “Fund”). Asian Century Quest Capital, LLC (“ACQ”) manages approximately \$1.8 billion in two Asian equity long/short strategies: the flagship strategy and a Smaller Companies strategy launched in April 2008. ACQ’s flagship strategy has produced solid absolute and risk-adjusted performance since inception from March 2005 through July 2011. Over this period, the strategy has generated an annualized net return of 10.01% and a standard deviation of 8.62%, resulting in a Sharpe Ratio of 1.13. The HFRI Equity Hedge (Total) Index has returned 4.99% over the same period. The fund ranks in the top quartile since inception within the Equity Hedge universe on a risk adjusted basis. The State of New Jersey Division of Investment invested \$75 million in two tranches, \$37.5 million each in August and September 2008. Our investment has returned 16.99% cumulative over the period August 2008 to August 2011 (annualized 5.22%) based on estimated August performance. Comparative returns for MSCI EAFE Indices for Japan, Korea and China for the same periods are -14.10%, 15.64% and 1.67%, respectively. The Division’s original investment carries a 2% management fee, 20% performance fee with a soft lock-up of 18 months. The proposed add-on will have same terms as the original investment. The fund has a high water mark and a 50% fund-level gate.

For each of the investments above, Chair Grady noted that the Investment Policy Committee had met and reviewed the due diligence materials prepared by staff and outside consultants, and had concluded that appropriate due diligence had been conducted.

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Mr. Marketti noted his opposition to each of the above investments.

Fiscal 2011 Proxy Voting Summary

Ms. Sarnowski provided the Council with the annual overview of the proxy season. The proxy voting policy is used as a guideline, with the Division applying its business judgment in voting the proxies. The Division voted 1,190 proxies of U.S. companies, with the Division voting against management on over 1,100 individual proposals. There were 1162 international proxies voted, with the Division voting against management on 871 proposals. The areas where the Division votes against management include the annual election of directors, shareholder's right to act by written consent and right to call a meeting. The Division continues to vote against stock option plans with greater than 5% dilution, plans that offer purchase at a discount or accelerated vesting. New proposals predicated by Dodd Frank included advisory votes on executive compensation (say on pay) and frequency of say on pays voting; the Division supports an annual vote frequency. Ms. Sarnowski updated the Council on the recent events which included the SEC's unsuccessful effort to put in place shareholder proxy access rules, which have been stricken by the U.S. Court of Appeals, and the delay in rules which would have required the Division to begin reporting its proxy voting results on executive compensation to the SEC annually. Ms. Sarnowski noted that a voting summary by Company was available upon request. Chair Grady stated that the Division had been appropriately tough with Companies through its proxy voting based upon the percentage of proposals in which it voted against management. He noted that an ironic and unintended consequence of the executive compensation votes required by Dodd Frank was the decline in shareholder opposition to individual directors in 2011.

Report from Audit Committee on fiscal 2011 audit

Council Member McGuckin stated that he and Chair Grady met with the auditors earlier in the day. Ernst & Young will be issuing clean opinions on the various financial statements. The work was completed prior to the Treasurer's designated deadline of November 1 through efforts of Division staff and the cooperation of the investment managers. The procedural item noted in the prior year management letter was addressed by staff and no management letter would be issued regarding internal control weaknesses for the current year. Chair Grady reiterated that there would be a clean opinion, with no material weaknesses noted, and that the NAVs of the various funds had been validated. He also stated that the Audit Committee met separately with Ernst & Young, without management present, and was informed that Division staff had been cooperative during the audit, internal controls were adequate, proper segregation of duties were in place and the reorganization within the accounting department, now led by Mr. Reynolds resulted in positive improvements. Management would issue their representation letter and the financial statements would be issued before the end of the month. Chair Grady also stated that the suggestion was explored to add a meeting or two during the course of the year between the auditors and the Audit Committee, much like the process for a large public company. Director Walsh added that he felt that the accounting department led by Mr. Reynolds, and Ms. Sarnowski was the most efficiently run department within the organization.

Treasurer's Report

Steve Harris stated that there was no report from the Treasurer.

Opportunity for Public Comment

Mr. Miskowski addressed the Council Members regarding his concern that the assumed rate of return being utilized for the pension funds is too high.

Chair Grady motioned to adjourn the meeting, with Council Member Oram seconding the motion. All voted in favor. The meeting was adjourned at 2:28 pm.